

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION AND PETITION OF)	
THE FARMDALE DEVELOPMENT CORPORATION,)	CASE NO. 8102
INC., FOR AN ORDER AUTHORIZING SAID)	
CORPORATION TO REVISE RATES)	

O R D E R

On June 3, 1981, the Commission issued an Interim Order authorizing Farmdale Development Corporation, Inc. ("Applicant"), to place into effect an interim rate for service rendered pursuant to KRS 278.190. The Interim Order further required that Applicant maintain its records in such manner as would enable it to determine the amounts to be refunded and to whom due, in the event a refund was ordered by the Commission upon final determination of this matter.

Applicant has responded to all requests for information and the record in this matter is now considered to be fully submitted for final determination by this Commission.

Test Period

For purposes of testing the reasonableness of the proposed rate, the Commission has adopted the twelve months ended September 30, 1980, as the test period. Adjustments, when proper and reasonable,

have been included to more clearly reflect current operating conditions.

Revenues and Expenses

Applicant proposed several adjustments to its test period operating revenues and expenses to more closely reflect pro forma operating conditions. The Commission is of the opinion that the adjusted levels of operating revenues and expenses are generally proper, and they have been accepted for rate-making purposes with the following exceptions:

1. Commissions

The Commission is of the opinion that the fee paid to Farmdale Water District ("District") for collecting and accounting for services rendered by Applicant is excessive based on the actual costs incurred by the District⁽¹⁾ and based on comparison of the expenses of other utilities with similar billing arrangements. The Commission is of the opinion that a just and reasonable fee should be based on actual costs rather than a set percentage of the bill and should further provide flexibility for change. The Commission has therefore allowed \$1.00 per bill and finds that this is a fair, just and reasonable fee for the Applicant to pay the District based on the District's cost of providing this service.

The Commission finds the present contract not to be in the best interest of the public. For these reasons the Commission urges

(1) Annual Report of Farmdale Water District for the year ended December 31, 1980, page 11.

Applicant to renegotiate a contract representative of the amount found reasonable above.

2. Legal and Accounting

During the test period Applicant incurred legal fees totaling \$2,431 associated with its defense in a suit involving the pollution of a stream.⁽²⁾ The Commission is of the opinion that these legal fees were extraordinary and will be non-recurring. The Commission has amortized these legal fees over a five-year period, thus reducing the test period level of legal and accounting expenses by \$1,945.

3. Amortization of Expenses Associated with Cases Before the Public Service Commission

During the test period Applicant amortized the costs of two previous cases before this Commission. The amortization periods were two and five years. The Commission finds that the unamortized balances for the cases were \$2,374 and \$1,085 with the annual allowances for amortization being \$3,165 and \$310,⁽³⁾ respectively. Since the unamortized balance for the shorter-lived cost was less than the allowance, the unamortized balance is the proper amount to be amortized. Therefore, the Commission finds the proper allowance for amortization of prior cases to be \$2,684.

4. Management Fee

Applicant proposed to adjust its management fee from \$3,600 to \$4,800. In support of this adjustment Applicant provided a list of duties performed by the manager and the average man-hours required to perform these duties.⁽⁴⁾ After reviewing this support and

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- (2) Applicant's Response, Exhibit 9.
(3) Applicant's Response, Exhibit 9.
(4) Applicant's Response, Exhibit 12.

~~cross~~-examining the Applicant's witnesses, the Commission is of the opinion that the duties performed for this management fee are comparable to the duties performed by managers in other similar sewer utilities. Therefore, the Commission has set the management fee at \$2,400 for rate-making purposes which is a level commensurate with those approved for comparable sewer utilities under this Commission's jurisdiction.

5. Repairs and Maintenance

After reviewing the invoices submitted in Applicant's response to item 14 of the Commission's information request, the Commission found that a number of invoices were paid and recorded during the test period which pertained to work performed during prior periods, indicating the use of the cash basis of accounting instead of the prescribed accrual basis. As of the end of the test period, an accrual basis of accounting was employed.⁽⁵⁾ Therefore, the Commission has disallowed the improper balances carried forward totaling \$1,182.

In addition, Applicant incurred service charges and interest on unpaid invoices totaling \$234 during the test period. A review of the invoices shows that most of these balances were paid in full by the end of the test period or soon thereafter. The Commission finds that Applicant obtained additional financing on various occasions during the test period including the final day.⁽⁶⁾ Therefore, since an appropriate normalization adjustment to interest has been made, the Commission has disallowed these service charges and interest on unpaid invoices for rate-making purposes, as to allow both would constitute double-counting.

(5) Applicant's Exhibit 1, page 1 and Applicant's Response, Exhibit 14.
(6) Applicant's Response, Exhibit 1.

During the test period, Applicant incurred pump repairs totaling \$5,451.⁽⁷⁾ Generally, these pump repairs were major overhauls, which in the opinion of the Commission should have been capitalized. The Commission further recognizes that without proper retirement accounting, the capitalization of these costs would overstate Applicant's plant in service. Therefore, the Commission is of the opinion that since these repairs would have extended the lives of the pumps and proper capitalization was impractical, it is proper to amortize the costs of these pump repairs over a three-year period. In addition, the Commission has allowed the amortization of pump repairs amortized in Applicant's previous case.⁽⁸⁾ Thus, the Commission's net adjustment to Applicant's test period level of repairs and maintenance is \$3,290.⁽⁹⁾

6. Utilities

Applicant normalized its utility costs based on the change in utility rates from the first to the last quarter. The Commission is of the opinion that a more proper adjustment would have been to apply the latest known and measurable rates to the test period usage. Using this method, the Commission has allowed an additional \$608 to more clearly reflect utility costs.

7. Depreciation Expense

Applicant proposed to include the cost of its original treatment plant in determining depreciation expense. There was some

(7) Applicant's Response, Exhibit 14.

(8) Commission Order in Case No. 7539.

(9) $(\$5451 \div 3) \times 2 = \$3,634 - \$344 = \$3,290.$

question as to whether this cost was expensed or capitalized at the time it was incurred as the cost was not included in Applicant's previous rate case. Applicant's financial witness, when questioned about an adjusting entry made to include this cost in his determination of depreciation expense, was unable to substantiate the adjustment.⁽¹⁰⁾ Therefore, the Commission has disallowed the cost of the original treatment plant in determining depreciation expense for rate-making purposes.

Applicant used an eight-year service life for most of its remaining depreciable property. The Commission is of the opinion that a proper service life for rate-making purposes for this property would be ten years and the appropriate adjustment has been made. In total, depreciation expense has been reduced \$2,375.

Therefore, Applicant's test period operations have been adjusted as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$24,841	\$ 5,008	\$29,849
Operating Expenses	<u>43,558</u>	<u>(5,887)</u>	<u>37,671</u> (11)
Net Operating Income			
(Loss)	\$(18,717)	\$10,895	\$(7,822)
Interest Income	71		71
Interest Expense	<u>1,259</u>	<u>3,005</u>	<u>4,264</u>
Net Income (Loss)	<u>\$(19,905)</u>	<u>\$ 7,890</u>	<u>\$(12,015)</u>

Revenue Requirements

The Commission finds the net operating loss to be unfair, unjust and unreasonable. The Commission has used the operating ratio method as the basis in determining sewer rates for the past several years and finds the results of this method have been reasonable and fair to

(10) Transcript of Evidence, Volume 2, page 7.

(11) Includes income taxes of \$1,244 based on revenues found reasonable.

both owners and ratepayers. The operating ratio method as used by the Commission is defined as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Operating Revenues}}$$

The Commission is of the opinion that a fair, just and reasonable operating ratio is .88 in that it will permit Applicant to pay its operating expenses, service its debt and provide a reasonable return to Applicant's owners. Therefore, the Commission finds that Applicant is entitled to adjust its rate to produce additional revenues of \$17,223.

Summary

The Commission, after consideration of the evidence of record and being fully advised, is of the opinion and finds that:

- (1) Applicant has filed with this Commission a valid third-party beneficiary agreement.
- (2) The rate prescribed and set forth in Appendix A is the fair, just and reasonable rate to charge for sewer service rendered by Applicant, in that based on test period conditions, revenues of \$47,072 will be produced.
- (3) An operating ratio of .88 is fair, just and reasonable in that it should permit Applicant to pay its operating expenses, meet its debt service requirements and maintain an adequate surplus.
- (4) The rate as proposed by Applicant and set forth in its notice would produce revenues in excess of those found to be reasonable herein and, therefore, must be denied upon application of KRS 278.030.

(5) The rate found reasonable herein is in excess of that found reasonable in the Interim Order dated June 3, 1981, and therefore, Applicant will not be required to refund any portion of the interim rate.

(6) Applicant should apprise this Commission of its renegotiations with District and/or provide a true copy of its renegotiated contract with District within 60 days from the date of this Order.

IT IS THEREFORE ORDERED that the rate set forth in Appendix A supersedes the rate set forth in the Interim Order dated June 3, 1981, and is fair, just and reasonable for sewer service rendered by Applicant on and after the date of this Order.

IT IS FURTHER ORDERED that the rate proposed by Applicant and set forth in its notice, insofar as it differs from the rate in Appendix A, shall be and is hereby denied.

IT IS FURTHER ORDERED that Applicant shall apprise this Commission of its renegotiations with District and/or provide a true copy of its renegotiated contract with District within 60 days from the date of this Order.

IT IS FURTHER ORDERED that Applicant shall file with this Commission within 30 days from the date of this Order its revised tariff sheet setting forth the rate approved herein.

Done at Frankfort, Kentucky, this 5th day of August, 1981.

PUBLIC SERVICE COMMISSION

Marlin M. Vohs

Chairman

Katharine Randall

Vice Chairman

Don G. Lapsen

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8102 DATED August 5, 1981

The following rates and charges are prescribed for sewage disposal service rendered to the customers in the area served by Farmdale Development Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect prior to the date of this Order.

Monthly Rate

Applicable to All Residential Customers

	<u>Rate</u>
Per Customer Connection per month	\$18.00